HOUSE BUDGET COMMITTEE

Democratic Caucus

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The Hidden Tax Agenda

The deficit bottom line in the Administration's *Mid-Session Review* (MSR) likely understates the cost of the budget's explicit program — because of rosy economic and technical assumptions. However, the MSR's omission of long-standing Administration priorities, and of unavoidable national priorities, poses at least as much risk to federal fiscal health.

On the spending side, the MSR continues to assume the President's underfunded prescription drug program for the elderly, and an understated baseline for the existing Medicare program; it continues to maintain that the new Homeland Security Department will be cost-neutral; it includes no allowance for inevitable natural disasters, such as hurricanes or floods; and it fails to account for the President's explicit spending increases, such as for foreign aid and the SEC, and his rhetorical support for underfunded priorities, notably education.

Still, the larger omitted agenda is on the revenue side. The Administration proposes $541 billion of new tax cuts, which is questionable enough with the budget already violating the Social Security Trust Fund surplus for as far as the eye can see. But then there are enormous further tax costs that are almost inevitable, or that the Administration has long-supported, but that are not acknowledged in the MSR. When those costs come due, they will markedly swell the deficit bottom line — as the chart on the next page demonstrates.

Alternative Minimum Tax

Perhaps the clearest, and probably the largest, instance of this problem relates to the individual alternative minimum tax (AMT). The AMT was originally intended to apply only to very affluent taxpayers who used tax shelters to escape most or all of their tax liability. However, key provisions of the AMT are not indexed for inflation, and so the mere passage of time will greatly extend the AMT's reach. By 2012, under the President's policies, the number of taxpayers subject to the individual AMT will grow from the current 2 million to 39 million — 34 percent of taxpayers with positive income tax liability, including almost half of all families with children.

In large part, this is due to the AMT's powerful interactions with the Republican tax cut passed last year. Many taxpayers who might be expecting tax reductions from last year's tax cut will be sorely disappointed when they see those tax cuts taken away by the AMT. The President's own February budget decried this problem (on page 77 of the *Analytical Perspectives* volume).

Pending and Prospective Tax Reduction 2003-2012

New Tax Proposals in Mid-Session Review (OMB)	141
Tax Extenders in Mid-Session Review (OMB)	62
Repeal of 2010 Sunset (OMB)	338
President's Mid-Session Review Subtotal	541
Make Permanent Stimulus Bill Depreciation (JCT)	245
AMT: Extension of 2001 Provision (CBO)	139
AMT: Hold Harmless for 2001 Enacted Tax Cuts (JCT/HBC)	127
AMT Hold Harmless at Current Incidence (HBC)	150 - 250
Other Tax Extenders (CBO)	166
Missing Pieces Subtotal	827 – 927
Grand Total	**1,368 – 1,468**

The prudent response a year ago, when the President and Congressional Republicans insisted on a trillion-dollar-plus tax cut, would have been to fix the AMT problem up front. However, Republicans instead inserted only a token relief provision — and then made that palliative expire at the end of 2004. The Administration probably assumed that future policymakers would solve the problem out of the revenue bounty they assumed would flow from their supply-side tax cut. (Indeed, both the Administration's FY 2002 budget and the Republican FY 2002 budget resolution made exactly the same assumption regarding the President's proposed but unfunded defense buildup.)

Clearly, the Congress will not allow the AMT to affect so many middle-class taxpayers. Unfortunately, the cost of softening or eliminating the blow of the individual AMT is very high. Merely extending the soon-to-expire provision in last year's enacted tax cut, which would barely begin to address the problem, costs $139 billion over ten years. Reducing the problem to its dimensions before last year's tax cut — which would allow the affected population to grow ten fold over the next ten years, instead of twenty fold — would cost another $127 billion. Then, reducing the number of taxpayers affected all the way back to today's levels would add another $150 billion to $250 billion — or more.

Tax Extenders

There are other expiring tax benefit provisions — "extenders" — that the budget ignores. The MSR devotes $62 billion to selective extensions of these provisions, most notably the research and experimentation (R&E) credit. However, CBO estimates indicate that extending the rest of these provisions would cost $166 billion over the next ten years. The following table shows a partial list of these popular provisions, many of which Congresses and Administrations have extended repeatedly in the past, and will almost certainly extend again.

Examples of Expiring Tax Provisions Ignored in the Mid-Session Review

Tax Provision	Expires	Revenue Cost 2003-12
Rum Excise Tax Revenue to Puerto Rico and Virgin Islands	12-31-01	0.7
Corporate Computer Contributions to Schools	12-31-03	1.3
Depreciation for Business Property on Indian Reservations	12-31-03	3.5
Investment Tax Incentives in Dist. of Columbia	12-31-03	1.7
Deduction for Qualified Education Expenses	12-31-05	21.2
Puerto Rico Business Credits	12-31-05	11.9
Credit for IRA and 401(k)-Type Plans	12-30-06	6.4
New Markets Tax Credit	12-30-07	2.3
Empowerment and Renewal Zones	12-31-09	4.2

Bonus Depreciation

Finally, the MSR is silent regarding the temporary "bonus depreciation" provision of the recent stimulus bill. To provide a quick boost to business investment demand, both Republicans and Democrats favored a temporary liberalization of depreciation deductions. However, the White House, in negotiations leading up to the conference on the bill, argued that the business benefit should be not be allowed to expire. For example, Council of Economic Advisers Chair R. Glenn Hubbard said in testimony before the Senate Budget Committee in October of 2001 that "Sound tax policy requires that such expensing be permanent." Though Democrats generally favored a one-year tax benefit, to increase the inducement to immediate action, Republicans insisted that this provision extend for three years — to expire just before the 2004 Presidential election.

Now, in the MSR, the White House shifts its field to assume that this tax benefit will expire — even though Republicans have consistently argued in other contexts that allowing a temporary tax cut to expire constitutes a “tax increase.” This sudden change of position makes the budget outlook more attractive — especially in light of the Administration’s pledge to bring the budget back to unified balance in 2005. However, given the Administration’s previously emphatic support of a permanent depreciation benefit, and the politically charged expiration date, it seems optimistic to assume that the Administration will stand by while this benefit to business interests expires, just before the election. Congressional estimates indicate that making the bonus depreciation provision permanent would cost another $245 billion.

More Troubling Implications for the Long Term

The revenue cost of the Administration’s hidden tax agenda could easily approach $1 trillion over the next ten years — on top of the acknowledged additional tax cuts totaling $541 billion. But the next ten years is only the beginning. Truly making permanent ***all*** of last year’s tax cut would drain $4 trillion from the budget between 2013 and 2022. Permanently repairing the AMT could add even more. Extending the other expiring tax provisions into the second decade of this century, on top of the other newly proposed tax cuts, would only add to this significant cost.

Putting the costs of all these elements of the President’s tax agenda “off the books” jeopardizes our nation’s finances — just as the Baby Boom’s retirement is about to put significant pressures on the budget.